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Integrated and coordinated implementation of and follow-up to the outcomes of the major United Nations conferences and summits in the economic, social and related fields

Follow-up to the outcome of the Millennium Summit

Follow-up to and implementation of the outcome of the International Conference on Financing for Development

Eradication of poverty and other development issues

Identical letters dated 20 September 2004 from the Permanent Representatives of Brazil, Chile, France and Spain to the United Nations addressed to the Secretary-General and the President of the General Assembly

Please find attached copies of the report of the Technical Group on Innovative Financing Mechanisms, issued on September 2004, entitled "Action against hunger and poverty" (see annex).

The report was prepared by the Technical Group deriving from the Geneva Declaration, which was subscribed by the Presidents of Brazil, Chile, France and, more recently, Spain, with the support of the Secretary-General of the United Nations.

It explores possible proposals for innovative ways of financing development, with their advantages and difficulties, in an attempt to demonstrate that there are indeed viable options to scale up international action through innovative approaches in parallel to traditional official development assistance flows, with a view to allowing for a balanced and inclusive globalization.

The report thus intends to provide a significant input to the ongoing discussion on innovative funding for development. The theme is especially relevant in the context of the follow-up to and implementation of the outcome of the International Conference on Financing for Development, as well as the follow-up to the United Nations Millennium Declaration, in the process leading to the high-level plenary meeting of the General Assembly, with the participation of heads of State and Government, to be held at the commencement of the sixtieth session of the General Assembly, in accordance with General Assembly resolution 58/291.

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We have the honour, therefore, to request you to circulate the present letter and its annex as a document of the fifty-ninth session of the General Assembly, under agenda items 45, 55, 84 and 89.

(*Signed*) Ronaldo Mota **Sardenberg**
Ambassador
Permanent Representative of Brazil to the United Nations

(*Signed*) Heraldo **Muñoz**
Ambassador
Permanent Representative of Chile to the United Nations

(*Signed*) Jean-Marc **de La Sablière**
Ambassador
Permanent Representative of France to the United Nations

(*Signed*) Juan Antonio **Yáñez-Barnuevo**
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Annex to the identical letters dated 20 September 2004 from the Permanent Representatives of Brazil, Chile, France and Spain to the United Nations addressed to the Secretary-General and the President of the General Assembly

[Original: English, French and Spanish]

Report of the Technical Group on Innovative Financing Mechanisms

September 2004

Action against Hunger and Poverty

This report has been prepared by the Technical Group deriving from the 2004 Geneva Declaration, which was subscribed by the Presidents of Brazil, Chile, France and, more recently, Spain, with the support of the UN Secretary General.

The Geneva Declaration states that the fight against hunger and poverty and the promotion of development will not be accomplished unless the gap between political undertaking and development financing is urgently bridged. At the moment, the implementation of financial commitments assumed by all nations remains uneven and slow. On current trends, the agreed goals and target dates will simply not be met.

Consensus runs deep that current aid levels will not suffice to finance the Millennium Development Goals (MDGs). United Nations and World Bank estimates indicate the need to increase the amount of aid currently available by at least US$ 50 billion per year until 2015.

In this perspective, the Group has studied various proposals for innovative ways of financing development.

The Group builds on existing work on the subject, including current efforts led by the United Nations. At its 24th Special Session, the UN General Assembly requested the international community to "conduct a rigorous analysis of the advantages, disadvantages and other implications of proposals for developing new and innovative sources of funding, both public and private, for dedication to social development and poverty eradication".

Why may innovative ways be necessary?

Inflows of Official Development Assistance (ODA) play a valuable role in providing countries with the immediate resources needed to unleash economic growth with social development. Foreign aid can be a decisive factor in improving economic infrastructure as well as education and health indicators.

But ODA today may be in need of a new -supplementary- approach aiming both at increasing the amount of resources available and ensuring better predictability of aid flows. That has been recognized as a particularly important condition for maximizing the impact of ODA. Rapid variations in the inflow of resources have a very negative incidence on the effectiveness of aid.

Existing sources of financing do not ensure predictability. Aid pledges depend upon internal budget decisions – which, in turn, are conditioned to changeable political circumstances. They lead to the suspension of projects that may never be resumed and may increase macroeconomic instability, especially when some expenses are made before resources are materialized.

The supply of more efficient, focused and predictable flows of aid capable of eradicating poverty in the world is truly a "public good" whose benefits would accrue to all nations. It will also help answering the much-debated question of absorption capacity: if aid were more stable, it could be absorbed and administered more effectively, and in larger amounts. Predictability should also contribute to transparency in the use of aid in recipient countries.

The Group has analysed a panoply of mechanisms for increasing aid flows – ranging from instruments that would be relatively easier to implement, including voluntary donation schemes, to other tools that would request strong and concerted political action.

All of them have in common, however, the premise on economic rationality. They are technically possible to implement and have already been analysed, in different degrees of detail, by renowned economists and scholars. They all share some basic principles. They are geared at supplying stable, predictable and substantial development assistance to poor countries. The idea is to make use of existing bilateral and multilateral channels for disbursement of resources. Funding should be made available preferably in the form of grants. Finally, resources raised should be managed in a transparent manner, so as to provide for adequate accountability of their use.

This report does not intend to present an exhaustive analysis of all possible mechanisms, nor to provide definite and prescriptive answers as to which of them should be adopted. It explores various options with their advantages and difficulties, in an attempt to demonstrate that there are indeed viable options to scale-up international action through innovative approaches in parallel to traditional ODA flows, with a view to allowing for a more balanced and inclusive globalization.

In so doing, Brazil, Chile, France and Spain welcome other countries, multilateral organizations, and the civil society, in particular NGOs, business community, trade unions and academia, to join efforts to implement the proposals.

Taxation of Financial Transactions

Monetary and financial assets are traded in broad, deep and liquid markets, many of which operate across the globe. The resulting volumes are consequently significant, even when measured against the commonest macroeconomic aggregates. Very low rates of taxation could yield high revenues, provided they are levied in a relatively coordinated manner among the major financial centres. Those taxes are examined with the sole purpose of raising funds for development. The level of taxation should be therefore low in order to minimize market distortion and the risk of evasion.

The impact of a transaction tax on investment decisions would be probably negligible, in comparison with that stemming from other measures or prudential

regulations surrounding the portfolio decisions of many financial intermediaries and institutions.

For many assets, there are already significant transaction costs compared to which a new, small increase in cost would probably have only a marginal impact. This is not the case in all markets, however, and any eventual taxation should therefore be considered with caution. Overall, a low rate of taxation on financial transactions could prove far less distorting than a higher rate of taxation applied to smaller tax bases.

The report concludes that a tax on foreign exchange transactions is technically feasible on a global level. It recommends that such a tax should be levied at the payment/settlement stage both for practical reasons and to minimize the risk of evasion.

Market making activities would have to be exempted. A tax would cause these activities to be in a state of permanent loss, which could lead either to further concentration among a very small number of major players, or to the complete demise of these activities, with the market adopting a different model of centralized price quotation. From the point of view of market efficiency and stability, the effect is uncertain. From the point of view of the tax, a sizeable fraction of the tax base would definitely disappear.

There is a risk of over taxation of some specific financial instruments (swaps, options). In theory, the tax could be circumvented by the use of derivative products or by swapping liquid securities denominated in two currencies, in place of the currencies themselves. However, these operations are more expensive and riskier than the straight transaction and would probably not be worthwhile if the tax rate were sufficiently low.

Taxation of the Arms Trade

The main rationale for such a taxation is that arms expenditures divert substantive financial, material and human resources that could be otherwise invested in social programs. Taxation would help raising funds to social-oriented projects and could lead to a reduction in acquisitions at least for some categories of weapons. It would also bring greater transparency and accountability in the arms trade, thus contributing to confidence and security building both at regional and international levels.

When devising the tax one should bear in mind that countries, including developing countries, have a right to defend themselves, whether they do produce or not the weapons they need. Also, the arms trade is both very competitive and highly concentrated, on the producer side. Universal participation is therefore a necessary condition.

For those reasons it is proposed the tax should be levied on all, new or used, heavy conventional weapon transactions, including purchases and donations, whether international or domestic. The tax levied on domestic transactions could be seen as a contribution to development financing made by arm producers, in direct proportion of their military equipment budget. This would send an important symbolic and political signal to the international development community.

For practical reasons, taxation should start with the seven categories of heavy conventional arms covered by the United Nations Arms Register. At the same time, full support should be given to the work that is being developed in the framework of the United Nations to conclude an international instrument on monitoring and marking of small arms and light weapons.

The greatest challenge is enforcement. Clarification and consultation provisions would need to be foreseen, both in order to check the accuracy of national declarations and as a deterrent to tax evasion. But attention should be also paid to issues such as the scope for the tax (components, technology transfers, immaterial goods, non commercial transactions).

International Financial Facility

The International Financial Facility (IFF) is a development financing mechanism proposed by the UK Government. Its objective is to allow for the frontloading of aid disbursements. It is based on an indebtedness scheme through which participating States securitize their increases in future ODA on the bond markets.

The main and strongest advantage of the IFF is that it does not require universality of participation and thus can be more easily implemented in the short term. It can be established on a regional basis or by a group of countries, since it does not immediately weigh on the economy and hence does not create problems of competitiveness for the contributing countries.

It would generate resources in a stable and predictable manner, the rate of disbursement being disconnected from that of contributions.

Careful attention must be given to the way commitments and the related bond placements are to be considered in national fiscal accounts, so as to forestall the possibility that they would be registered as government liability in domestic accounts and thus result in higher debt to GDP ratios in donor countries. Also, the IFF's governance structure still has to be drafted. It is important to ensure that new organizational costs be the lowest possible, so as not to erode political support for the Facility.

It is not clear whether middle-income countries affected by hunger and poverty problems would also be entitled to benefit from the mechanism. It would be interesting to analyse the possibility of taking into account not only aggregate national statistics, but also regional indicators among the IFF's eligibility criteria for the destination of resources, thereby not excluding some middle-income countries from the mechanism's scope of application.

As with all borrowing, the IFF transfers the burden of repayment onto future generations and therefore creates a major question mark for the long term future. After 2015, a fraction of developed countries' ODA budgets will be absorbed by IFF repayments. At that point, this could lead to a sharp reduction in net flows toward poor countries. This is a real risk, especially for those countries in Sub-Saharan Africa which, even on strong assumptions for growth and increasing national tax revenues, will still be unable to shoulder the burden of public spending essential to human development. There should be a mechanism guaranteeing that after 2015 aid will still flow on an additional basis and in sufficient amounts to those countries.

The IFF constitutes a creative mechanism that could effectively address the urgent vital need for raising resources to the combat against poverty and hunger. The IFF also has significant complementary features with international taxation schemes outlined in this Report. The mechanism can be used jointly with other instruments when expenditures designed to benefit present and future generations are closely combined within a single program or action.

SDRs for Financing Development

The idea of issuing new Special Drawing Rights (SDRs) for development purposes was first raised in the 1960's. More recently, the proposal loomed again in the context of international efforts to identify new sources of funding to meet the Millennium Development Goals. New allocations of SDRs would present more than one advantage. While incrementing the amount of resources currently available to the fight against hunger and poverty, new SDRs would significantly address financial volatility and imbalances and contribute to the creation of an international economic environment more conducive for development with social equity.

The IMF's Board of Governors approved a one-time allocation of SDRs in September 1997 through the proposed Fourth Amendment of the Articles of Agreement, the purpose of which is to enable all IMF members (including those who have joined after the date of the last allocation, in 1981) to participate in the SDR system on an equitable basis. The first challenge is therefore to galvanize political support to get the pending Fourth Amendment approved. Then, developed countries could agree to make available their share in this allocation, either to developing countries or to existing multilateral Funds.

The idea is that existing or future SDRs could be used for development purposes, thereby enhancing the efficiency and stability of the world economy.

SDRs could also be issued on a temporary basis during episodes of widespread financial stress and significant drop in commodity prices, and could be cancelled once financial conditions are normalised. Such an approach would provide for a useful counter-cyclical component in world liquidity management. It is known that developing countries, in general, continue to face the longstanding volatility of their export proceeds and private capital inflows. The systematic allocation of new SDRs could help and alleviate this volatility.

One could also consider the possibility of issuing new permanent SDRs, for instance, by an amount equivalent to a fraction of the annual increase in the demand for international reserves.

Transfers of SDRs, however, raise the issue of interest charges due by recipients, which will have to be dealt with according to individual countries situations.

Tax Evasion and Tax Havens

Tax evasion is a phenomenon of great magnitude that impairs fiscal revenues of governments and is especially detrimental to the domestic efforts to increase tax revenue in developing countries. Tax evasion frequently involves offshore financial

centres, as concealment seeks the protection of systems combining zero or low taxation with banking secrecy.

Further joint and concerted international action is necessary to reduce the erosion of national tax bases.

Reducing tax evasion and bringing more transparency to financial operations are international public goods, that additionally can contribute to increase financing to fight poverty and to enhance development. In all, it would increase world welfare.

Given its global nature, the issue of tax evasion must be dealt with in the context of strengthening international cooperation in tax matters. There must be no relaxation of efforts currently underway. If the expected results fail to materialize, States engaged in this process should consider taking coordinated defensive measures, particularly fiscal measures.

Increasing Remittance's Benefits

Globalization is characterized by the existence of important international flows of workers. The decision to migrate frequently emerges from a family recognition of the need to obtain an additional source of income. Remittances tend to be much less pro-cyclical than other flows, thus providing a more stable and predictable source of financing. They are normally spent in common expenses such as food, housing and utilities, and therefore represent an alternative safety net in developing countries.

The cost of sending remittances should be reduced. Therefore, the first and foremost measure would be for developed countries to facilitate foreign workers' access to financial institutions at an affordable cost. At the same time, the financial systems of many developing countries do not generally reach the majority of their populations. Assistance should be given to developing countries, when needed, to spread the base of the financial sector in order to efficiently channel these flows towards productive activities, including the access to microfinance by families of recipients.

Voluntary Contributions through Credit Cards

Voluntary contributions are also an important dimension of the effort to raise new resources to financing the fight against hunger and poverty. Credit card-based donations, in particular, have already been in place in many parts of the world. The launching of an affinity card identified with the implementation of the Millennium Development Goals could build on existing successful experiences involving banks, credit card companies and individuals.

As with other affinity cards available in many countries, clients would simply agree to donate a small percentage of the value of their purchases to the worldwide campaign against hunger and poverty. In addition to contributions focused on individuals, options involving a joint voluntary effort by credit card holders and the major credit card companies and associated banks also deserve consideration. Some of these companies and/or banks could indeed agree to donate a very small percentage of their earnings with annual fees, interests etc. of their contributing clients.

Since it involves the coordination among a relatively small number of actors and builds on existing experiences, the initiative could be implemented in the short run. Benefits would stem not only from the amount of resources raised, but also from the increased publicity of the Millennium Development Goals among consumers and private companies from all parts of the world.

Socially Responsible Investing or "Ethical Funds"

Socially Responsible Investing (SRI) refers to investment decision-making processes that combine the social and environmental dimensions of investments with rigorous financial analysis. Over the past two decades, concerns about global warming, human rights and labour standards have been at the forefront of socially responsible investing. More recently, an important initiative was launched by United Nations Secretary General Kofi Annan – the "UN Global Compact" – congregating today more than 1600 companies from all regions of the world which have agreed to follow a set of common principles on labour standards, environment protection and human rights. SRI encompasses three main investing strategies: shareholder advocacy/activism, community investing and portfolio screening.

The bulk of SRI strategies refers to portfolio screening, i.e., the practice of including or excluding publicly traded securities from investment portfolio or mutual funds according to certain social or environmental criteria. For instance, investors who stick to positive screening tend to channel their money to companies that follow above average records in terms of pre-established values – like better employer-employee relations, social policies or the safety and social usefulness of their products.

Funds oriented to social values – the so-called "ethical funds" – are becoming very popular among investors. Estimates show that SRI funds have reached the impressive figure of US$ 5.9 trillion all over the world.

However, the fight against poverty and hunger has not so far been explicitly taken as a SRI screen. The constitution of portfolios of securities of companies from different parts of the world that are committed to allocate resources to fighting hunger and poverty in developing countries should be encouraged. Such funds could yield good financial performance while providing an incentive for companies to invest more systematically in social programs for hunger and poverty eradication.

The mechanism would build on existing successful experiences, all of which based on voluntary participation. The initiative is expected to request relatively low administrative costs and relatively low international coordination efforts.

Final Remarks

The list of innovative mechanisms examined in this Report is neither exhaustive, nor prescriptive. The Group kept an open mind with regard to other suggestions analysed elsewhere. The Group acknowledges that there are political constraints for the adoption of new mechanisms. There is no intention of proposing such mechanisms as the ultimate solution to development financing, in substitution for traditional forms of official assistance, debt relief or trade-related measures that would help promote growth in developing countries.

The mechanisms analysed in this Report are not conceived simply as a provisional measure to address urgent needs of developing countries. Rather, they are designed as means of providing for a predictable and continuous flow of resources over time, so that recipient nations could succeed in the pursuit of long-term development in a more efficient manner.

With regard to modalities of participation, it should be borne in mind that some mechanisms would be compatible with "flexible geometry" coalitions, by bringing together groups of interested parties. Nonetheless, with respect to taxation schemes, the widest possible participation, including by all key players, often seems to be necessary. Although this requirement may represent a serious obstacle to their entry into force, taxation mechanisms would still be worth pursuing. By providing for resources in a stable and predictable manner, taxation schemes would efficiently complement ODA, which suffers from ineffective fluctuation in its level due to donors' domestic budget contingencies. Taxation mechanisms could complement other mechanisms, by offering the possibility of combining different modalities of financing devoted to more immediate, urgent measures and to long-term, structural projects.

It is crucial that resources raised through innovative mechanisms are truly additional, and do not crowd out current ODA flows. The channelling and use of the resources levied through these innovative mechanisms will be guided by the following general principles: efficiency, accountability, and transparency.

The mechanisms examined should be seen within different timeframes of maturity. In fact, some of the instruments examined would be ripe for adoption in the short term, either because they have sufficient critical mass and in-built financial engineering, or by virtue of their apparently simple conceptualization and implementation, or yet by the fact that they would be based on national successful stories.

We must recognize that it is time to consider the subject of alternative sources of financing as a top priority. The international community cannot afford a wait-and-see attitude. Each year lost represents an increase in resources needed in the run-up to 2015. Let us not waste further time.